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C O N F I D E N T I A L BUENOS AIRES 001224

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TREASURY FOR O'NEILL, TRAN, MALLOY

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TAGS: EFIN ECON PREL AR

SUBJECT: ARGENTINA: PRESIDENT KIRCHNER ANNOUNCES THAT GOA WILL PAY PARIS CLUB

REF: BUENOS AIRES 1160

Classified By: Amassador E.A. Wayne. Reasons 1.4 (B,D)

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Summary  
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¶11. (C) President Kirchner (CFK) announced today that Argentina would pay \$6.7 billion in Paris Club (PC) debt out of central bank reserves. It remains unclear whether the GoA intends to repay its PC debt in full or simply pay down arrears (the most recent Paris Club Secretariat data shows Argentina's arrears to the PC at \$6.57 billion, with an additional \$1.35 billion in outstanding principal). Economy Minister Fernandez told Ambassador, however, that the GoA recognizes that it will need to reconcile the numbers with its official creditors. The GoA announcement follows a number of private discussions with CFK, with her Chief Minister, and with other in the GoA over the importance of resolving the PC issues, and post had received feedback suggesting that some consideration of action was in the works. Nevertheless, the GoA decision to unilaterally pay down PC debt came as a surprise. Most of our previous discussions with GoA officials had focused on possible GoA efforts to make a voluntary settlement offer to creditors through the Paris Club Secretariat.

¶12. (C) While market values of untendered "holdout" debt are up on the CFK announcement, market sentiment here, as evidenced by senior economists' comments at a lunch with Federal Reserve Governor Kroszner, remains mixed. Some criticized it as a poor move from a cash flow perspective (since the GoA could have negotiated a gradual payment agreement with creditors), a move that would facilitate white elephant infrastructure projects funded by export credit agencies like the French-supported "bullet train," and a sign of GoA desperation. Others suggested hopefully that it could mark a first step by the GoA in addressing macroeconomic disequilibria. Economy Minister Fernandez told the Ambassador that the move was aimed at sending positive signals to foreign investors as well as to Paris Club members. In our view, the move represents a salutary effort by the GoA to try something new in its economic policy strategy. To encourage this new approach, we support a statement by the USG welcoming the move. Foreign Minister Taiana spoke to the Ambassador soon after the announcement and expressed the GoA's hope that the USG would issue such a supportive statement out of Washington. End Summary.

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CFK Enlivens Industry Day with a Bombshell  
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¶ 13. (U) In a surprise mid-day announcement in a speech recognizing Argentina Industry Day, President Cristina Fernandez de Kirchner (CFK) said that she had signed a decree authorizing the use of central bank (BCRA) "freely available" reserves to repay Argentina's \$6.706 billion of debt with the Paris Club (PC). "This is an important step of state policy, which is to cut our debt....this payment reaffirms Argentina's willingness to pay its international commitments." It is not clear whether the GoA intends to repay PC debt in full or simply to pay down arrears. According to the most recent Paris Club Secretariat data (as of April 2008), Argentina's arrears to the PC, including late interest, amounted to \$6.57 billion, with an additional \$1.35 billion in outstanding principal.

¶ 14. (C) In the aftermath of early August market turmoil linked to an expensive private bond issue to Venezuela and rating agency downgrades of Argentine debt, GoA officials have received a steady stream of advice over the past few weeks that now is the time to seriously address PC arrears and so begin the process of regularizing Argentina's relationships with international capital markets. Ambassador had raised PC with Council of Americas President Susan Segal August 26, and Segal discussed PC with CFK later that day. On August 27, Ambassador and Assistant Secretary Shannon urged a GoA PC initiative in a meeting with Chief of Cabinet Sergio Massa and earlier Shannon raised it with Foreign Minister Taiana. Citibank Country Manager Juan Bruchou had delivered much the same message to Massa earlier that week. PC was also a topic of discussion in an August 29 meeting between Econoff and Finance Secretary Lorenzino and in September 1 meetings by Ambassador and Federal Reserve Governor Randy Kroszner with BCRA President Martin Redrado. (Comment: Neither Redrado

nor Lorenzino even hinted that this announcement was in the offing.)

¶ 15. (C) In a September 2 telcon, Finance Secretary Lorenzino advised U.S. Treasury desk officer that the decision to fully pay down PC arrears had been made in meetings between the Office of the President and the Economy Ministry over the August 30-31 weekend.

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Ministers Hope for U.S. Support: "Beautiful Surprise"  
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¶ 16. (C) In a telecom with the Ambassador a few hours after CFK's speech, Taiana characterized the announcement as "positive news" that deserved a positive response. He expressed his hope that the Departments of State and/or Treasury could make positive comments on CFK's decision to pay down PC debt. (As of this writing, we understand that the State Department will make such a statement.)

¶ 17. (C) Ambassador also spoke to Economy Minister Carlos Fernandez hours after the president's announcement. He characterized it as a "beautiful surprise" for those following Argentine foreign debt issues, and said that GoA officials believed that it would send positive signals to Argentina's international partners, including the USG. Fernandez indicated that the GoA had arrived at the \$6.706 billion number for Argentina's Paris Club debt through individual consultations with creditor governments. He hastened to add, however, that the GoA recognizes that it will need to reconcile this number with other estimates. On the legal question of using BCRA reserves to pay the GoA's debt to bilateral creditors (para 9), Fernandez said that lawyers at the President's office were developing a strategy that would ensure that the operation was legally defensible in Argentina.

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Economists Divided on Impact  
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¶ 18. (C) Following the announcement, during a lunch hosted by the Ambassador in honor of visiting Federal Reserve Governor

Randy Kroszner, a number of senior Argentine economists offered their views on the announcement.

-- Javier Gonzalez Fraga, former central bank governor, called the announcement a net negative. The GoA's use of BCRA reserves will be seen by markets -- and especially by bond holdouts -- as "cheating." He also called it a poor GoA move from a cash flow perspective, since a gradual repayment schedule could have been negotiated with the Paris Club Secretariat. He added, however, that the payoff represented "a return to the markets" by the GoA, which he characterized as positive.

-- Javier Kulesz, a Union Bank of Switzerland economist, called the GoA announcement a net plus that markets could interpret as a signal that the GoA is "changing course" in order to address macroeconomic disequilibria, including high domestic inflation and a diminishing primary fiscal surplus. To convince markets that the GoA had indeed turned a new leaf, he continued, the GoA would need to supplement the announcement with additional market-friendly news in the weeks to come.

-- Ricardo Arriazu, former IMF Director and private consultant, argued that the announcement was a mistake because, by using reserves rather than a better managed fiscal surplus, the near-term consequence will be a decline in the equilibrium exchange rate, "once again cheating holders of domestic currency assets."

-- Federico Sturzenegger, President of Buenos Aires' Banco Ciudad, was ambivalent. Technically, he said the move to pay off the debt was positive because the discount rate on the obligation was so high. Nonetheless, he suggested that markets may interpret the GoA move in a negative light, as an admission that Argentina is desperate to regularize its standing with international capital markets because it needs significant new credits to remain solvent. He called Argentina's longstanding pariah status in international capital markets a blessing in disguise, because it prevented Argentina from repeating its past borrowing excesses.

-- Daniel Artana, chief economist of macroeconomic think tank FIEL, called the GoA announcement net neutral, with capital markets unlikely to respond markedly to a GoA paydown of only \$7 billion of some \$150-odd billion in total GoA debt. He called Spain the big loser here, having earlier cut a side deal with the GoA to reschedule payment some \$800 million of (what Spain argued was) non-Paris Club sovereign arrears over eight years. Artana saw an inflow of export credit agency financing that that will likely result from a Paris Club settlement as offering the GoA additional opportunities to "poorly manage" new public infrastructure spending on white elephant projects like the controversial French-supported "bullet train" project.

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Using Reserves: Legal Questions, Holdout Impact  
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¶9. (SBU) There are legal restrictions in place which limit the ability of BCRA to use its "freely disposable" reserves to pay down PC arrears. While such BCRA reserves can legally be used to pay debts to international financial institutions (a paydown of \$9 billion to the IMF was made in December 2005), the GoA must borrow from the BCRA, subject to ceilings on borrowing as both a percentage of base money supply and as a percentage of GoA revenue inflows for the prior 12 months, in order to use reserves to pay debts to bilateral creditors.

¶10. (C) Former BCRA governor Fraga estimated current BCRA reserves at the \$43 billion level (\$48 billion less \$5 billion in BIS borrowings). In response to a question, he said it is not at all clear that the BCRA has adequate free reserves to pay down some \$7 billion in PC arrears without breaching the above-noted ceilings. Economists attending the

lunch agreed that any change to these ceilings would require approval from Congress, but that, in any case, the GoA would craft some workable legal mechanism to ensure the reserves could be used. They also agreed that bond holdouts, who have unsuccessfully argued in U.S. courts that BCRA reserves should be attachable assets, will take any paydown of PC arrears as a cue to redouble their attachment efforts. Fraga noted that the BCRA is skilled in engaging in financial operations in a way that makes it difficult for claimants to attach assets, and others noted that the GoA had won previous legal challenges from the holdouts on this matter.

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Comment

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¶111. (C) Following a number of private discussions with CFK, with her Chief of Cabinet Sergio Massa and with others in the GoA over the importance of resolving the PC issues (see para 3), we had received an inkling that some kind of action was in the works. Nevertheless, the GoA decision to pay off most or all of its PC debt (perhaps just outstanding arrears) came as a huge -- and pleasant -- surprise. Most of our previous discussions with GoA officials had focused on possible GoA efforts to make a voluntary settlement offer to creditors through the Paris Club Secretariat. The sudden announcement harkens back to ex-President Nestor Kirchner's (NK's) December 2005 decision to follow Brazil's example and use BCRA reserves to pay down some \$9 billion in IMF debt. Given NK's preeminent role in GoA economic decision making, it appears likely that he played a key role in this decision. Given that it may have been decided just days before, we also expect that there are a number of questions related to the pay-back that the GoA has not yet worked out, or perhaps even thought about yet.

WAYNE